

# *The New York* Certified Public Accountant



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WENTWORTH F. GANTT

*Managing Editor*

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CERTIFIED PUBLIC ACCOUNTANTS

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## STATE SOCIETY ACTIVITIES

### Calendar of Events

May 10—Regular Meeting of the Board of Directors.

May 10—7:30 P.M.—Annual Meeting of the Society. Location: Waldorf-Astoria Hotel, Lexington Avenue at 49th Street, New York City. Subject: **Relief Provisions of the 1942 Revenue Act.** Speaker: Randolph E. Paul, General Counsel of the Treasury Department.

June 10—Regular Meeting of the Board of Directors.

June 25-27—Tenth Annual Regional Conference, Hotel Saranac, Saranac Lake, New York.

### Membership for Committees

In order to facilitate the appointment of committees for the year 1943-44, President-elect Levy requests that members desirous of serving on technical committees of the Society (a list of which appears in the Year Book) advise the Society's office concerning those on which they feel qualified to serve. Committees will be selected during the summer and will take effect on October 1, 1943.

Members expressing a desire to serve on committees and accepting committee appointments should realize that acceptance conveys a willingness to assume the responsibilities of a member of the committee, and to attend meetings and work on the activities of the committee.

### Address by Randolph E. Paul

The address prepared by Randolph E. Paul, General Counsel of the Treasury, on **"The Relief Provisions of**

**Section 722 of the 1942 Revenue Act"** which was read at the May 10th meeting of the Society by Mr. J. G. Blandi, Special Assistant Chief Counsel of the Bureau of Internal Revenue, will be published in the June issue of **THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT.**

### Election of Officers

On May 10, 1943, the election of officers and directors of the Society for the forthcoming year was held at the Waldorf-Astoria Hotel. The Nominating Committee submitted the names of the following officers and directors for the ensuing year, who were subsequently elected to office. They will assume office on October 1, 1943.

### OFFICERS

Saul Levy .....President  
Henry A. Horne.....First Vice-Pres.  
Wm. R. Donaldson, Second Vice-Pres.  
Charles H. Towns .....Secretary  
Harry E. VanBenschoten..Treasurer

### DIRECTORS

(For a Period of Three Years)

Benjamin Harrow J. Arthur Marvin  
Charles L. Hughes Arthur E. Surdam  
C. Oliver Wellington

### DIRECTOR

(For a period of One Year)

Ernest O. Lothrop

Mr. Levy, in accepting his election as President of the Society, spoke as follows:

I am deeply grateful to all of you for the honor which you have con-

ferred upon me this evening. I fully realize that it carries with it your mandate to the newly elected officers and directors to maintain the work of this Society on the high plane of public service and technical competence that has been achieved so admirably by our able predecessors in office. We will do our utmost faithfully and effectively to discharge the responsibilities which you have asked us to assume. Speaking for myself, I feel at this moment fortified particularly by the thought that our good friend Arthur Marvin is to continue on our Board of Directors. I think it is most fortunate that we are to have his active help during the critical period beyond the time of his own incumbency as President.

Certified Public Accountants during the past year have been going through a period of extreme difficulty, but by the same token it has been a period of unprecedented opportunity for us. Members of our profession have left their peace-time work to assume high executive and administrative posts in the War Department, the Navy Department, the War Production Board, the Office of Price Administration and numerous other governmental agencies. They are functioning directly in the public service in capacities for which their life work has best fitted them. Many of them responded to calls which came long before Pearl Harbor, thus enabling them to make a relatively early contribution to the preliminary organization, as well as to the later full-fledged development, of a war program that has deservedly been called a miracle of production. Large numbers of accountants of broad experience have entered the service in technical capacities to implement the plans of those already occupying key positions in the war program. In addition to all of this, many of our rank and file have entered the armed forces for combatant duty.

This direct contribution of our professional personnel to the public service has in no way lessened the need for our services on the home front. The efficient administration of our tax laws is more important and more difficult than ever, dependent as it always has been upon the maintenance of proper accounting records and the availability to taxpayers of professional aid in the preparation of their tax returns. The government in its vast procurement and financing programs has stressed repeatedly the importance of relying, where it can, upon audited accounts and certified statements. Those of us remaining on the home front are bound to play a vital role, extremely helpful both to the government and to contractors, in accomplishing just results for all concerned in the renegotiation of war contracts. When the hour of victory comes, and contract termination claims are the order of the day, the expert handling of this extremely difficult phase of our war economy will create the crucial need for our most active cooperation in order that these matters may be dealt with expeditiously as well as equitably.

In most of the situations to which I have so briefly referred, it makes little essential difference whether our efforts are exerted in an official capacity or as independent public accountants retained by those dealing with our government. In either capacity we shall be serving the public interest, and in either capacity we shall be making a valuable contribution to the total war program. We must be prepared to deal with these problems in greater volume and in greater complexity than ever before. We must perform our task on the high level of peace-time professional standards, yet with the reduced and depleted personnel of war-time. Ordinary concepts of what constitutes the impossible are obsolete for the duration. Every group

of workers and technicians in our great nation must accept war as the challenge and command to surpass all its previous achievements. No less will be our task.

Despite the imperative claims on the time and the energy of each of us in his own particular job, we know that we must function more effectively than ever as a professional group. Through our Society we must work collectively and cooperatively toward a better understanding of the problems that now press upon us and those that will confront us, soon we hope, in the post-war period. We must afford our membership a forum for the discussion of all questions affecting our work and we must together strive to promote and exploit every opportunity to make our services count in the public interest.

During the months to come we shall be giving an increasing amount of thought to the part we must play in the reconversion of our economy from a war-time to a peace-time basis, and to the program of post-war reconstruction which has been so aptly called the winning of the peace. We have a vital contribution to make both to the government and to the business community in helping to give important guidance and direction to the formulation and the administration of national economic policies. Financial and cost data must be adequately recorded, expertly analyzed and intelligently interpreted if future financial and economic policies are to have a factual foundation and if the carrying out of such policies is to be properly supervised and checked. Much of this work falls well within the field of accounting technique and our training and experience should be available for these purposes. In continuing to serve commerce and industry as independent certified public accountants we shall play a

more useful role than ever before. Beyond this we should accept important responsibilities in the public service and the government should not neglect to extend such opportunities to us. During the past decade we have been a liaison between business and government on a widening front and during the critical post-war period our availability in this capacity should be an even more important function of our profession.

The time which we as members will give to our meetings, to our publications and to our committee work will not be time lost to our professional activity. On the contrary, it will have the same direct relationship to our output of services that the engineering and research departments of our huge factories have to production on the final assembly line.

During the year ahead many of you will be called upon to participate actively in the work of our Society. I know you will respond as earnestly in the future as you have always done in the past. By so serving our Society we will be serving our profession, and by making our profession increasingly useful we will be serving our nation. We all look forward with grim determination and unwavering confidence to the great events of the immediate future. We mean to be worthy of the total victory that is on the way.

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#### **Tenth Annual Regional Conference**

The Tenth Annual Regional Chapter Conference will again be held at the Hotel Saranac, Saranac Lake, New York, on June 25-27.

The program is in process of being arranged and will consist of subjects pertaining to accounting under war-time conditions. A notice outlining the complete program of the Conference will be sent to the membership at a later date.

### **October Meeting**

The regular October meeting of the Society will be held on Monday, October 18, 1943, as a part of the program of the American Institute of Accountants Annual Meeting which is to be held in New York, October 18-21. Announcements of the Institute's meeting and of the Society's part in the program will be given in a later issue.

### **Last Prize Essay Contest Notice**

Members' attention is directed to the Prize Essay Contest which closes on June 1, 1943, announcement of which again appears in this issue on Page 301. It is hoped that a large number of papers will be submitted.

### **Amendments to the By-Laws**

At its meeting on May 10, 1943, the Society approved the following amendments, effective on October 1, 1943, to Article II, Paragraphs 1, 2, 3, 4 and 5:

Strike out present paragraphs 1, 2, 3, 4 and 5 of Article II—Fees, Dues and Assessments which read as follows:

1. Except as elsewhere prescribed in these by-laws, the annual dues for members shall be \$25, except that until a member shall have held a certificate as certified public accountant from any state, or a certificate, license, registration or substantially equivalent authorization issued or granted pursuant to a law, charter or act of a foreign government, for a period of three years, his annual dues shall be abated to \$15. In the case of a member who holds any such authorizations from more than one jurisdiction, the said abatement shall be granted only if the earliest

authorization received by him shall have been held for less than three years.

2. If a member has his residence and regular place of business at a greater distance from City Hall, New York City, than 25 miles, the annual dues of such member shall be one-half the amount elsewhere prescribed in these by-laws.

3. Dues shall not be required from associate members for any period prior to October 1, 1941. Beginning with October 1, 1941, any associate member who shall then or thereafter have occupied that status for five years, shall, after the said five years, pay annual dues to the society in the amount of \$10 if he has his residence or regular place of business within an area within twenty-five miles from City Hall, New York City; and annual dues of \$5 if his residence and regular place of business are both at a greater distance from City Hall, New York City, than twenty-five miles.

4. Dues shall not be required from life members or honorary members.

5. Except in respect to a newly elected or advanced member, dues shall be payable semi-annually in advance, on the first day of April and the first day of October in each year. The dues of any newly elected or advanced member shall commence on the day on which he shall have been elected or advanced and shall be payable on the first day of the next following month.

In place of the foregoing, the following amended By-laws are to be substituted:

1. Annual dues for life members, honorary members, members, and associate members shall be as shown in the following schedule:

## State Society Activities

Classes of Members	If residence or place of business is in the City of New York or in the counties of Bergen, Essex, Hudson, Passaic, or Union of the State of New Jersey	If residence or place of business is in the counties of Albany, Erie, Monroe, Niagara, Onondaga, Rennselaer or Schenectady of the State of New York	If residence and place of business are in territory not previously specified
Life Members and Honorary Members	None	None	None
Members who, for a period of three or more years, have held a certificate as certified public accountant from any state, or a certificate, license, registration or substantially equivalent authorization issued or granted pursuant to a law, charter or act of a foreign government .....	\$25	\$17.50	\$12.50
Members who, for a period of less than three years, have held such a certificate or equivalent authorization.....	\$15	\$10.50	\$ 7.50
Associate members who have occupied that status for five years or more....	\$10	\$ 7	\$ 5
Associate members who have occupied that status for less than five years...	None	None	None

2. Except in respect to a newly elected or advanced member, dues shall be payable semi-annually in advance on the first day of April and the first day of October in each year.

3. Newly elected or advanced members shall pay one-half the annual dues for the semi-annual period within which their election or advancement occurs if elected or advanced during the months of April, May, June, October, November or December, and the dues shall be payable on the first day of the month following their election or advancement. If elected or advanced during the months of January, February, March, July, August or September, dues shall commence with the beginning of the following dues period and shall be payable on the first day of said period.

4. If the dues, as a result of the holding of a certificate for three or more years or as the result of having been an associate member for five or more years, are to be increased, as

provided in Paragraph 1 of this Article, during the first three months of a dues period, they shall be billed at the beginning of the period at the higher rate; and if during the last three months of a dues period, they shall be billed at the lower rate and the higher rate shall take effect for the next dues period.

5. If a member shall change his residence or regular place of business so as to affect his rate of dues, such change in rate shall become effective at the beginning of the next dues period following such change.

The Society approved the adoption of the following amendments, effective on October 1, 1943, to Article IV—Chapters which now reads:

### Article IV—Chapters

Members residing or having a place of business within the State of New York elsewhere than in the City of New York, may organize subsidiary bodies of this Society to be known respectively as

chapters of this society. The organization of a chapter and the manner in which its affairs shall be conducted shall be governed by such rules and regulations as the board of directors may prescribe.

The foregoing Article IV is to be amended by making the present Article the first paragraph of the amended Article, inserting at the beginning the numeral "1" and by the addition of paragraphs 2 and 3 so that Article IV as amended will read as follows:

1. Members residing or having a place of business within the State of New York elsewhere than in the City of New York, may organize subsidiary bodies of this society to be known respectively as chapters of this society. The organization of a chapter and the manner in which its affairs shall be conducted shall be governed by such rules and regulations as the board of directors may prescribe.

2. A member or associate member residing or having a place of business in the counties of Albany, Erie, Monroe, Niagara, Onondaga, Rennselaer or Schenectady of the State of New York shall be automatically a member or associate

member of the chapter nearest his residence or place of business.

3. The society, from the dues collected for each semi-annual period, shall remit to the treasury of the chapter for each chapter member or associate member, the sum of \$2.50, if the member has held his certificate for three or more years; the sum of \$1.50, if the member has held his certificate for less than three years, and the sum of \$1.00, if the associate member has occupied that status for five or more years.

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**Frederick C. Ludemann**

Frederick C. Ludemann, a member of the Society since May 1938, passed away on March 7, 1943.

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**Thomas Francis Gorman**

Word has just been received of the death in March, 1943, of Thomas Francis Gorman, a member of the Society since February 1936.

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The Society has suffered a great loss in the passing of these members.

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*It is the Patriotic Duty  
of Every American Citizen to:*

**BUY United States War Bonds and Stamps**

**GIVE to the Red Cross**



## ANNOUNCEMENT OF PRIZE ESSAY CONTEST

The Board of Directors of the Society has authorized the Committee on Publications to conduct a prize essay contest, the essays to be on a subject of interest to the accounting profession and suitable for publication in THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT. Prizes in the amount of \$150 for first prize, \$100 for second prize, and \$50 for third prize are offered.

The general rules of the contest are as follows:

All manuscripts shall be typed in duplicate on 8½ x 11 stationery, double or triple space typing, and should not be more than 5000 words.

★

The name of the individual submitting the paper shall not appear on same, nor should there be any other means of identifying the manuscripts, which should be accompanied by a covering letter giving the contestant's name and address and firm connection.

★

When submitted to the judges, each manuscript will be given a key number of identification.

★

Manuscripts should be forwarded to The Managing Editor of the New York Certified Public Accountant, 15 East 41st Street, New York City, on or before June 1, 1943. Awards will be announced as soon thereafter as possible.

★

All papers submitted shall become the property of the New York State Society of Certified Public Accountants and shall be available for publication in the New York Certified Public Accountant. The decision of the judges shall be final as to what papers may be entitled to prizes.

## PROFESSIONAL COMMENT

### Releasing Powers of Appointment

The Revenue Act of 1942 contains provisions for the release of powers of appointment which (by joint resolution passed thereafter) must be released before July 1, 1943.

A bill was passed in the New York State Legislature this year which should be of interest to our members in connection with this matter.

The bill follows:

"Section 1. Chapter fifty-two of the laws of nineteen hundred nine, entitled "An act relating to real property, constituting chapter fifty of the consolidated laws," is hereby amended by inserting therein a new section, to be section one hundred eighty-three, to read as follows:

Sec. 183. Release of a power, 1. Any power which is exercisable by deed, by will, by deed or will, or otherwise, whether general or special, other than a power in trust which is imperative, is releasable, either with or without consideration, by written instrument signed by the grantee and delivered as hereinafter provided.

2. A power which is releasable may be released with respect to the whole or any part of the property subject to such power and may also be released in such manner as to reduce or limit the persons or objects, or classes of persons or objects, in whose favor such power would otherwise be exercisable. No release of a power shall be deemed to make imperative a power which was not imperative prior to such release, unless the instrument of release expressly so provides.

3. Such release may be delivered to any of the following:

(a) Any person specified for such purpose in the instrument creating the power.

(b) Any trustee of the property to which the power relates.

(c) Any person, other than the grantee, who could be adversely affected by an exercise of the power.

(d) The county clerk of the county in which the grantee resides, or has a place of business, or in which the deed, will or other instrument creating the power is filed, for filing under section one hundred sixty-seven of the county law.

Sec. 4. This section shall apply to releases hereafter delivered, and also to releases delivered heretofore but on or after July first, nineteen hundred forty-two.

Sec. 2. This act shall take effect immediately."

### A Refresher Course in Writing

A Refresher Course in Writing will be given by John Mantle Clapp in the Society rooms beginning June 1st. The two-hour practice sessions will take up four problems that constantly recur in letters, memos, working-papers, reports and articles.

Detailed attention will be given to the technique of—

Sentence construction, the heart of the problem of securing accuracy, completeness and conciseness without loss of directness: Methods of making complex ideas clear. Devices for avoiding monotony.

Words and Phrases: Obtaining

*Professional Comment*

precision and expressiveness by means of simple words, elimination of "jargon" and holding abstract terms to a minimum. The resources of synonyms.

Paragraphs: Methods of linking statements, spot-lighting important points and making a passage read easily. Variety devices.

Organization of material: Effective patterns of arrangement.

The case material, examples of wording, sentences, patterns, etc. will be drawn from current reports and other accounting writing. Members can bring their own material to this laboratory course for analysis and individual advice.

There will be a fee of \$25. Accountants who are interested should inquire at the Society office for further information.

**If you can't go**

**GIVE!**



**RED CROSS WAR FUND**

# Renegotiation of Government Contracts— U.S. Army Organization and Procedure

By LT. COL. CHARLES H. DYSON, A.A.F.

THE members of the accounting profession can make a truly valuable contribution to the renegotiation program of the Army, Navy, Treasury and Maritime Departments and, by so doing, to American Business.

The prime function of the Army and the Navy is to fight this war and to win it. That fight, however, is a many-sided one. It makes demands upon soldiers in the Solomons and in Africa, and workers at home in our factories. It takes brains and brawn, and labor and capital, and management and industry. It takes a planned and disciplined adherence to one great cause.

Renegotiation is not a spectacular part of the victory program, but it is a truly significant factor. It was designed to be, and must be made, the outstanding medium by which American business, while producing for war, keeps its own house in order and preserves its competitive toughness for peace.

The renegotiation statute is not a Vinson-Trammel Act revival. It contains no exact standards, no mathematical formula, by which excessive profits are determined. At the urgent requests of the War and Navy Departments, the Congress rejected proposals which included such flat profit limitations in favor of the present flexible law. The adoption of this statute constituted an acknowledgment of the fact, proven by experience, that none but the most flexible standards can fairly be applied to all types of businesses.

Because renegotiation standards

are few and flexible, however, much depends upon the understanding and ability of those who administer the statute. Experience indicates that this law is being well administered by contractors and their accountants and lawyers as well as by the Price Adjustment Boards.

After a year of experience, this joint enterprise by renegotiators on the one side and contractors on the other has produced results which prove that the renegotiation program works, and which justify the hopes of the Price Adjustment Boards for it.

## Procedure:

The Price Adjustment Boards of the Navy and Treasury Departments and Maritime Commission, are operating agencies engaged in active renegotiation with their contractors.

The War Department Price Adjustment Board, on the other hand, is concerned primarily with the establishment and administration of policies, the assignment of cases and the final approval of completed renegotiation agreements. The actual renegotiations are generally conducted by the various sections in the Services of Supply and the Army Air Forces. The procedure followed by all these Price Adjustment Sections is substantially the same. Therefore, though the following comments pertain only to the Army Air Forces, it is believed that they will be substantially applicable to all these Price Adjustment Sections.

*Presented at the April 12, 1943 meeting of The New York State Society of Certified Public Accountants at the Waldorf-Astoria Hotel, New York City.*

The assignment of a company will normally be made to the Army Supply Service for which the contractor does the bulk of its business, either as prime or subcontractor. The Price Adjustment Section located nearest to the main office of the company will then be assigned the responsibility for handling the renegotiation. This regional office usually will request the company to submit financial statements and schedules covering the past six years. The material received pursuant to this request is summarized by a member of the Financial Analysis Unit together with other information which may be available to the Army Air Forces or the other Services.

After the Financial Analysis Unit completes its review of the company's financial statements, a first meeting is arranged with the company. It is usually the practice, wherever possible, to schedule this meeting at the company's own office, to enable the negotiator to familiarize himself, to some extent, with the company's plant and its operations and to speak with the resident War Department representative.

The importance of this first meeting cannot be over-emphasized. It is at this time, that, through a clear understanding by the company of what data is required, the procedure which will be followed, and the factors to be considered in renegotiation, many of the difficulties sometimes encountered may be avoided.

In addition to the financial statements previously received, the following list of subjects, covering additional factual information required by the negotiators, is reviewed:

- (1) Affiliated companies.
- (2) Ownership and affiliations of supplier.
- (3) Business of supplier.
  - (a) Nature of normal peace-time business.
  - (b) Extent to which previous production facilities and

experiences are utilized in war production. (c) Location of plants with present and prospective capacity. (d) Principal war production competitors.

- (4) Nature of suppliers assistance to Government.

(a) Complexity of war products manufactured. (b) Development of new war products or production methods. (c) Cost of conversion, changeover or expansion. (d) Assistance given to other contractors, such as pooling of patents, drawings, processes, materials, etc.

- (5) Government assistance furnished the supplier.

(a) Plant and machinery provided. (b) Advances, progress payments, guaranteed loans, etc. (c) Technical assistance, engineering designs, patents of others used. (d) Estimate of sales made on Government facilities.

- (6) War production facilities financed by supplier.

- (7) Subcontracting policy.

- (8) Salaries and wages including bonus plans of principal executives.

- (9) Special problems or risks.

(a) Shortages of material, skilled labor, etc. (b) Program changes. (c) Inventory risks. (d) Lawsuits. (e) Plant expansion. (f) Post war conversion problems. (g) Expected changes in wages and material prices.

At this meeting the company is asked to submit a statement of its work in the war program, and to describe its contributions, such as inventive genius or production performance, so that full credit may be given where credit is due.

When all necessary facts about the company have been gathered, the negotiator completes his report covering, among other things, the subjects shown above, a statement

of his opinion as to the amount, if any, of excessive profits for the period under review and the reasons for his decision. The Price Adjustment Board of the District discusses this report with the negotiator and then reaches its opinion of the amount of excessive profits of the company under consideration. At a later conference, this opinion is conveyed to the company officials, who generally agree to transmit it to their Board of Directors for consideration. When an agreement is reached with the contractor, the written renegotiation agreement, together with its covering report, is forwarded for review to the commanding officer of the Supply Service concerned. If approved by that officer the agreement is transmitted to the War Department Price Adjustment Board. If the agreement is approved by the Board the company received what is in effect a clean bill of health for the period under review.

That, in its briefest form, is the procedure normally followed in renegotiation. There is no rigid pattern and in many cases variations in procedure are adopted in the interests of getting the task accomplished rapidly and with the minimum amount of inconvenience to the contractor.

#### **Problems:**

Any program as far-reaching and as important in its impact on the nation's economy as renegotiation must of necessity be surrounded by a multitude of problems.

Many contractors are disturbed by the fact that there is no formula for the determination of excessive profits to be found either in the statute or in the statements of the Price Adjustment Boards. Those who have worked longest on renegotiation and, it is believed, contractors who have concluded renegotiation agreements, are unanimously of the opinion that the best interests of the business community have been

protected precisely because the law is a flexible one, which confers broad discretion upon the administrative authorities.

Another difficult problem arises in connection with post-war reserves. By order of the War Production Board post-war reserves cannot be considered as costs in determining excessive profits in renegotiation. A partial answer has been given to this problem by the Excess Profits Tax Credit and the provision for two-year carry-back or carry-forward of losses. The determination of the adequacy or inadequacy of these partial answers is part of the post-war problem that Congress is considering for the Country.

Another of the major difficulties is that of recognizing that there are usually two separate phases or steps in renegotiation. One is the determination of excessive profits and the other is the financing of a business. It is suggested that attention be directed first to the determination of the excessive profits and then to the time and method of repayment. The primary consideration of the War Department is production and the negotiator will not require a basis of repayment which will impair production, put the company out of business or be impossible to carry into effect. At the same time it is very important to remember that various ways of financing companies through Government assistance have been developed and it is not intended that companies should be allowed to finance themselves through the realization of excessive profits.

During the period of one year of renegotiation, certain questions have arisen with such recurring regularity as to indicate strong need for clarification. It is believed that some have recurred because the negotiators have not adequately outlined the exact nature of the information required. If an accountant clearly understands the nature of the opera-

tion of renegotiation in these respects he can render both his client and the Government great service through eliminating a good deal of needless work.

The problem referred to informally as segregation of sales and costs is one which, if properly understood, will not require an unreasonable amount of work and, if properly understood by the accountant, can be satisfactorily disposed of without any inconvenience to a manufacturer.

The Army Air Forces has prepared a printed memorandum of the principles to be used in segregation of renegotiable and non-renegotiable business. This memorandum<sup>(1)</sup> should be used as a guide for the segregation of the sales that *must* be included for renegotiation of the sales which *may* be included by agreement with the contractor, and of sales which *must not* be included. The segregation of renegotiable and non-renegotiable business need not be done by a complete analysis of each sale. In making the segregation reasonable proof may be obtained by the use of priority ratings, the end use of the product, test checks of a portion of the period of the sales, War Production Board records of the segregation of business of a particular industry between war and civilian use, and if none of these apply, by a method agreed to by the company and the Price Adjustment Section. The allocation of costs and the allocation of expenses must follow the segregation of sales and the principles used in sound accounting. The renegotiator will always endeavor to agree to a reasonably defensible method.

The statute excludes from renegotiation contracts and subcontracts with respect to which final payment was made prior to April 28, 1942. Here again certain business may have to be segregated. This segregation may be accomplished by one or

more of the methods suggested in the memorandum of principles of segregation of sales.

In a great many cases a contractor has had published statements of other companies, sometimes his competitors, and quite naturally attempted to determine what effect renegotiation has had on those companies. Without knowing how much of the company's sales are subject to renegotiation, it is impossible to determine this, yet almost daily, negotiators are confronted with conclusions based on such inadequate information. Comparisons cannot be made in this manner. Furthermore, the bare figures, even if known, would not always give the complete story, for in many cases allowance is made in one manner or another for certain contributions in production and development work which are known only to the Government and the contractor involved. Comparisons of this type can be of no real assistance to contractors or to renegotiation. By pointing this fact out to companies, accountants will assist in dispelling doubts which otherwise quite naturally arise.

Contract renegotiation is unique in one respect. It is the first instance in which Congress has delegated to a group composed largely of business men and manufacturers the administration of a profit limitation statute. The success of the administration will depend not only on the conscientious, impartial and intelligent work of these men but also on those who have remained in the ranks of business and industry and in the private practice of their professions. It is the duty of all associated with the renegotiation program to perform their assignment as effectively as possible. The success of renegotiation depends largely on the assistance and cooperation received from contractors and their representatives.

Close control of prices and profits

<sup>(1)</sup> Copies available at the office of the New York State Society of CPA's.



in war materials has become a vital part of the campaign to prevent inflation. Such close control should also assist industry and the war effort by encouraging low-cost and efficient production which in turn means the greatest possible volume of production with the smallest commensurate use of men and materials.

It is to these ends that the Price

Adjustment Boards are directing their activities and it is for these reasons that they invite the support and cooperation of American industry. It is in this way that the members of these Boards and the businesses from which they were so recently recruited can be helpful in the winning of the war and of the peace to follow.

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*If you can't go across—*

COME ACROSS

BUY  
UNITED STATES  
WAR BONDS



# Renegotiation of Government Contracts— U. S. Navy Organization and Procedure

By COMMANDER N. LOYALL McLAREN

THE last time I was on this platform I remember with keen pleasure that another speaker on the same occasion was a gentleman who is down in the front row tonight: Mr. Norman Webster. That was on the occasion of the fiftieth anniversary of the birth of the accounting profession in the United States, and both Mr. Webster and I dealt with certain historical aspects of the development of the accounting profession in that half-century period. Today I will deal with a subject which has a much shorter history. After all, the renegotiation statute was passed only on April 28th of last year, but it has been my privilege to be associated with the work of the Navy Price Adjustment Board even before the statute was passed.

The first case considered jointly by the Army and Navy was the Sperry Corporation, on April 21st of last year. That case, incidentally, was a voluntary renegotiation which received quite a bit of publicity at the time; it was the first important one. Since that time I have been sleeping and living with renegotiation.

I have enjoyed very much listening to what Colonel Dyson said. He is also a veteran in the field of renegotiation. It has been a great pleasure for our Navy Price Adjustment Board to have established such a close and understanding relationship with the price adjustment sections of the Air Corps. As a matter of fact, in the case of the larger aviation companies, we have worked together on a very very close basis with the idea (which is prevalent through-

out the process of renegotiation) of attempting to work out settlements—regardless of which price adjustment board: the Army, the Navy, the Maritime Commission, or the Treasury has a predominance of interest—which will be equitable as between companies engaged in the same general type of enterprise.

Recently a friend of mine who is one of the leading certified public accountants of this country said to me, "I think that a mistake has been made in shrouding the administration of the renegotiation statute in a veil of mystery. If contractors were informed of the type of people who were administering the process of renegotiation and the way they approach their task, it would be most reassuring."

Upon reflection, I realize that most of the articles, editorials and addresses on this subject have dealt with the philosophy of renegotiation rather than with the administrative side. In fact, they have been more in the nature of excerpts from the Marquis of Queensbury rules rather than a blow-by-blow description of what might be called a championship bout. A refreshing departure from the cut-and-dried formula to which I have made reference can be found in an address of your President, J. Arthur Marvin, before an upstate meeting of The New York State Society of Certified Public Accountants in which he described renegotiation from the contractor's corner of the ring. I will try to tell you what happens in the challenger's corner during and between rounds; and don't conclude from this

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*Presented at the April 12, 1943 meeting of The New York State Society of Certified Public Accountants at the Waldorf-Astoria Hotel, New York City.*

simile that in the Navy Price Adjustment Board we are pugnacious. Actually the reverse is the case as I will develop for you.

First it is appropriate to mention at a gathering of this character the part played in the work of renegotiation in the Navy by the Cost and Audit Division of the Office of Procurement and Material. The Cost and Audit Division is unique in one respect. As far as I know it is the only technical group in the Navy Department at Washington in which the entire personnel are commissioned officers, and we are very glad it is this way because everybody is playing the game under the same rules. Attached to the Cost and Audit Division in Washington and the two regional boards in Chicago and San Francisco are approximately thirty-five certified public accountants; the number includes half a dozen men who would be considered outstanding members of our profession by any method of appraisal.

Actually, we operate along quite the same lines as would be found in the case of a substantial accounting office in a large city. We have what in effect amounts to partners and supervisors and seniors and juniors. A great many of our men are out on field assignments.

In addition to the division in Washington, we have another unique organization in government; that is our panel of supervising auditors consisting of about 150 certified public accountants throughout the country. The idea of starting this panel of supervising auditors belongs to George Auld, another member of the New York State Society. Mr. Auld, who had been active in cost inspection work and chief of the Cost Inspection Division in the Navy Department during the first war and who was in the regular Navy, realized almost a year before Pearl Harbor that the accounting profession was in a position to make a valuable

contribution to the Navy. He saw that advice on cost accounting matters by people who had made it their life study would be highly valuable to the Navy. So he offered to form a panel consisting of partners and principals and managers of highly reputable accounting firms, who would work on part-time and intermittent bases at a very low rate of compensation, to assist the Navy in connection with technical matters arising in connection with cost inspection.

When the renegotiation statute was passed last April, here was a ready-made group which could be sent out to the offices of large contractors and assist them in compiling the information required for an intelligent consideration of their cases. In the instructions which were worked out, the emphasis from the beginning has been on simplicity. There is nothing in the procedures which smacks of a detailed audit. However, the Navy and contractors generally realize the importance of making an adequate record which can withstand challenge in the event that when this is all over Congressional committees or others start making investigations, as is their wont.

From time to time the regulations prescribed by the Navy Price Adjustment Board have been changed. But always when these changes are made, the emphasis is on simplification and the elimination of details which constitute irritants in the eyes of the contractor. One of the men who has had the most to do with these instructions to our field representatives has been another member of the New York State Society—Lieut. Leslie Mills, who is in the audience.

Now, let me say something of the personnel of the Navy Price Adjustment Board. Every member of the board was on the other side of the fence before Pearl Harbor. All

the members were businessmen or lawyers or professional accountants who were not regular Navy men. The chairman of the board was the president of a Nitrate Company. One of the other members was a very well-known engineer from New York City. Another member was a Wall Street man—a partner of a very well-known brokerage firm. Another was a former partner of a large firm of investment bankers with headquarters in Chicago. Another member was a certified public accountant. Actually there are two certified public accountants on the board, because Carman Blough has the unique distinction of serving as a member of all the price adjustment boards; he is the liaison representative for the WPB. Now none of these men, nor the C.P.A.s, nor the financial analysts who have been recruited mostly from banking firms, nor the lawyers are in any sense social reformers, academic “long-hairs” or bureaucrats; and I think it is quite reassuring to contractors, especially those who haven’t followed the process of renegotiation closely, to come down to Washington to appear before our board and find that they are actually dealing with businessmen with the viewpoint which might be expected of businessmen.

In addition to the Washington office, we have regional offices in San Francisco and in Chicago. There again the entire personnel of the regional boards consists of businessmen. In San Francisco the chairman of the board is a former head of a large shipping and shipbuilding company who retired a number of years ago and who is now back working for the Navy. The chairman of the board in Chicago is the president of two local banks in Chicago. And so on, down the line.

We are about to have a rather drastic change and one which has taken a good deal of time of Lieu-

tenant Commander Wagner and myself during the last few weeks. A survey indicated that there will be approximately 4,000 cases in which the Navy Price Adjustment Board has a predominance of interest relating to the year 1942. All those cases must be started and moved along before the close of the year and, in order to accomplish this object, we determined that it would be wise to open a branch office in New York. So, a week from next Monday, we are opening offices in the International Building, in Rockefeller Center, and several of the board members will be stationed here permanently and also a major portion of our accounting staff and analysts. We figure that we will have to get under way approximately 1,500 cases out of this office, which will take care of the New England States, New York, Pennsylvania, New Jersey, Delaware and Ohio before the end of the year; so you can see that we have quite a task ahead of us. It may be necessary to add to the personnel; but I think the Navy is rather fortunate in having retained in the price adjustment organization a considerable number of veterans who have been with this thing from the beginning; so our problem involving dilution of labor will not be a very serious one.

The question is often asked: “Just what is the philosophical approach of the price adjustment boards to determining what constitutes excessive profits?” Editorials and articles which I have seen, particularly the various utterances of one individual who is conducting a one-man crusade against renegotiation and who floods Congress with telegrams—frequently put the emphasis in the wrong place. The Navy Price Adjustment Board—and I feel this goes for all the price adjustment boards—does not place its emphasis on what constitutes an excessive

profit, but rather on the absolute obligation of the price adjustment boards to leave successful war contractors a reasonable margin of profit.

Now Colonel Dyson spoke about the original assignment of cases to the agency which has the predominance of interest. That is a somewhat complicated problem in the War Department as compared with the Navy. Of course you know in the War Department they have seven—I believe it is—separate services, each one of which is rather highly organized; but in the Navy we only have one: (we are just simple, seafaring men, and fortunately our complications are not quite as great as in the case of our brothers in the other service). When I say “simple seafaring men” I see you smiling. To prove that such is the case, I want to report that Commander Wagner had his first touch of the sea a few days ago when he took the night boat to Norfolk.

In the Navy as soon as our predominance of interest is established we get out a preliminary letter to the contractor in which we ask him to submit annual reports for two years, profit and loss statements, and a brief statement of the extent of his conversion to the war effort, and a few other details with respect to his earnings which can be assembled very readily. The only question that he cannot answer offhand is the approximate breakdown of his business between Government end use and commercial end use. This estimate is essential in our preliminary study. When the information is received back in Washington (and incidentally after we move to New York all the preliminary phases of the case will continue to be handled in Washington), a rather sketchy examination is made of the contractor's record of performance through the technical bureaus and other sources. Then a meeting is held, and at one meeting we may consider pre-

liminary reports on twenty-five, thirty or forty cases, which are then disposed of in various ways.

In the first place, if it is evident there is no excessive profit for the period, the contractor is immediately given clearance; and, in the case of a calendar-year corporation, that period will be for clearance up to December 31, 1942. In that connection I think it will be of interest to this audience when I tell you that a great deal of importance attaches itself in the minds of the entire membership of the Navy Price Adjustment Board as to whether or not the contractor submits audited figures. The tendency on the part of the members of the board where a war contractor has no auditor is very definitely to look upon the case with a somewhat jaundiced eye. And I have heard members of the board who are not certified public accountants, when the preliminary figures were a little bit close but on the face did not indicate any excessive profits nor any excessive salaries or other matters that would lead us to go right ahead through the usual process, say “Well, this company has submitted no audited figures, and consequently I think it might be well to send someone in to have another look.” There is of course, a fraud section in the statute; so that if later the contractor's statements turn out to be fraudulently misleading, the case may be reopened regardless of technical clearance.

We have some instances in which preliminary figures are submitted subject to year-end adjustment, and if those preliminary figures indicate that the margin of profit is not excessive, the contractor will be told that if his final figures don't vary materially from the figures submitted first he will be given clearance when the final figures come in. There will be other cases where preliminary figures are submitted containing insufficient data on which to

proceed. Here a letter is sent to the contractor enclosing the general instructions followed by our field group, and he will be asked to go over those instructions with his independent auditors with the thought that they may assist him in compiling the desired information.

The last type of case is where the board feels it has sufficient information to indicate a *prima facie* case of excessive profits. There, as I have indicated before, the field work will be done by one of our panel of C. P. A.'s or by one of the field representatives from the Cost and Audit Division of the Office of Procurement and Material in Washington.

We have received very valuable assistance in connection with this field work through the cooperation of the supervisory cost inspectors in the several Naval districts. Captain Farwell, who is here tonight, is the Supervisory Cost Inspector of the Third Naval District, and Captain Farwell and his two chief assistants, Mr. Mills and Mr. Hastings, have been very helpful to us. We are going to call upon them a great deal in the next few months because we are being deluged with year-end figures and we must all pitch in in attempting to handle this work in an expeditious manner.

When the report comes in from the field, the next step is just as auditors would find in their own offices: a final report, based on the field report is prepared usually in collaboration between one of the financial analysts and one of the certified public accountants in our group. It has two distinct parts: The first is the assembly of all the accounting and financial data, and the second is a rather complete statement of performance. We find from each of the interested technical bureaus in the Navy what they think of the performance of the contractor, his cooperation, his ability to cut costs, his willingness to take on

work in a new field where he may be assuming a large risk: all the elements that enter into evaluating performance are developed through the technical bureaus. At the same time, if the case is one in which the War Department or the services of the War Department or the Maritime or Treasury have a substantial interest, we also obtain performance data from them; and all that material is put together in a final report.

Now before the contractor is called in to a meeting, there is a preliminary meeting at which the board members consider carefully the data developed in this final report. There is no attempt in the final report to establish what is a fair margin of profit. The case of a contractor is not prejudged before he is given an opportunity to put his best foot forward. But the board members familiarize themselves with the highlights of the case. That is followed by a meeting with the contractor's representatives.

I want to emphasize the informal nature of the proceedings when a contractor appears in Washington or at one of our other offices for renegotiation. No stenographic record is made of the case and there are no formal rules of practice. The contractor is at liberty to bring any representative that he cares to; we have had all the way from one to fifteen representatives of the contractor in attendance at our meetings.

I have been impressed with the fact, however, that if the contractor's independent accountant is a man of stature and experience, that is, if he is one of the partners of the firm or a principal who is a man of considerable experience and ability, it is very helpful, provided that the accountant has been close enough to the affairs of his client to make a positive contribution. Just to have him there for "scenery" if the audit has been of a limited nature, is not

impressive; frequently, however, the independent accountants have been most helpful in developing important factors in the case that might otherwise have been overlooked.

Questions often arise with respect to the propriety of the treatment of certain costs, as well as other technical accounting matters; hence, it is very important for the contractor to be represented by someone who has a close familiarity with the accounts. The best combination is the comptroller or chief accountant, plus the independent auditor if he has the requisite familiarity with the case.

After the contractor has had a full opportunity to put his best foot forward,—to brag a little bit about his contribution to the war effort (and most contractors are in a position to brag, honestly, about what they are doing) the chairman of the meeting, who has studied the case more intensely than the other members (and the chairmanship rotates through our several members), asks the contractor a few questions with respect to matters on which the record may not be completely clear. That usually leads to a discussion, and perhaps a reiteration of the points which the contractor wishes to stress. After he has been given a full opportunity to present his case—a full hour, a day, or even longer; there is no time limit—then the contractor is asked to leave the room while the board goes into executive session.

After the board has discussed the case fully and various points advanced by the contractor have been appraised, we resort to informal balloting. The chairman of the meeting will say, "If there is nothing more to be considered, we'll take a preliminary ballot." Everyone writes down on a piece of paper the amount which he thinks should be returned to the Government as excessive profits; and it is quite surprising

how often the whole group will hit the amount either "right on the nose" or with slight variations. Sometimes, however, as for example when new factors enter into the case for which there are no precedents, there will be a considerable spread in the first ballot. Our custom, under these circumstances, is to talk to the man who is farthest off first, and ask him how he arrived at his figure, and what weight he attached to various factors; and sometimes we will find there has been a misunderstanding of some of the facts. By the balloting system we think that we are accomplishing two constructive purposes: In the first place, certainly the case of the contractor is not being prejudged; and in the second place, we avoid the domination of the proceedings by the man who happens to have been chairman of the case and to have devoted the most time to its preliminary study. I think that it is a very democratic and fair way of dealing with a matter which, of course, is so vital to all the contractors who appear before us.

We have a great variety of people with whom to deal. The difference in their approach is amazing. Let me tell you of two experiences we had recently on successive days to illustrate what I mean.

The first case was that of a company in the radio field, whose executive organization embraced some of the greatest scientists and research people in the radio industry—an organization with a magnificent reputation for performance, with a perfect report from all the technical bureaus of both the War Department and the Navy with whom it dealt. The two men who came down to Washington were the chief executive officer and the comptroller. Right at the start the chief executive officer said, "I have been authorized by my board at a meeting yesterday to commit our company



to whatever proposition can be worked out here today if, in my judgment, it is within reason." And so we listened to the very very interesting story of what this company had accomplished. When the contractor was through with his presentation and we felt we had a pretty clear understanding of the case, we asked him to step out of the room a minute. After considerable talk we arrived at an amount which we thought should be refunded. It was difficult to evaluate the performance in this case, because we didn't have much in the way of comparable cases; but finally we did arrive at an amount. The company officials were asked to return, and the chairman of the board said, "We have had a hard time. We are sorry to have kept you out of the room so long, but in view of the remarks which you made at the beginning of the meeting it occurs to me that perhaps you have an amount you would like yourself to suggest in the way of a refund". The head of the company said, "Yes, I have"; and he gave us the amount, which happened to be exactly 33 $\frac{1}{3}$ % more than the amount we had arrived at. That never happened before and the board was thrown into a state of temporary confusion. Finally the suggestion was made that we go into executive session, which we did. We only stayed there about three or four minutes, then asked these people to come back in again and said, "We believe in dealing with a full deck, with all the cards on the table. We were somewhat taken aback by your proposition because the amount we had in mind was so-and-so and that is still the amount we'd like to suggest to you as a refund"; whereupon the confusion was continued by the chief executive saying, "We have discussed this matter at great length in our board, and we really feel that we know more about the

excessive profits of the company than anyone, and we must insist that our original proposition stand." And that was how the case was settled.

On the following day, we had two brothers, the sole stockholders in a machinery manufacturing company. They had started in 1939 with borrowed capital of \$14,000. For the year 1942, after paying salaries of \$50,000 to each of them, the company had a net profit before taxes of slightly over \$2,000,000. That profit was over 100% on cost. And I had the misfortune to preside at the meeting. I talked myself blue in the face for three hours, and at the end of that time these men were just as convinced as when we started that they were the victims of persecution and that they had made no excessive profits whatever.

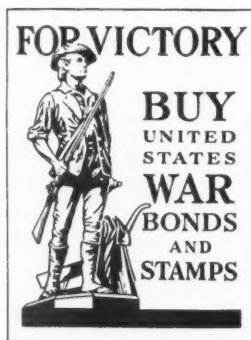
I think those cases were the two extremes within my experience. A few days ago we had some people down there at a very pleasant meeting, and again it was a rather difficult case for us to evaluate. We kept them waiting for some little time and, in the midst of the proceedings, Commander Wagner and Lieutenant Mills walked into the meeting and said, "Something unusual is going on across the hall and we don't know how to handle this. While the fellows are waiting they're playing gin rummy". "We asked them if they were playing for high stakes, and they said, "Not nearly as big as those across the hall".

Now I would like to say just one thing before closing. The statement has been made that the Navy Department differs from some of the other price adjustment boards in that it tends toward the cost-plus view in renegotiating excessive profits. It is alleged that cost-plus contracts encourage extravagance; that they were outlawed a number of years ago, and that what the Navy

is doing in effect is to reestablish that principle in renegotiation. Nothing is further from the truth. Bear in mind that almost invariably in the cases which we consider today we are dealing with the figures of a closed period; so that what we do can have no bearing whatsoever on the cost for the period already closed. But the important thing to have in mind is this: that in evaluating a fair margin of profit, in seeing that a contractor is left with a fair margin of profit, one of the factors to which the greatest plus value attaches is affirmative action on the part of the contractor either, as Colonel Dyson has said, by developing substitutes for critical materials, or improving production methods, or by effecting positive economies in other ways. When the year-end comes around, that is a

factor to which all the boards attach major importance.

On the other hand, if when 1943 comes up for renegotiation, a few misguided contractors may have had the unfortunate notion that the more they spent the more return they would receive (because it is so easy to relate ultimate profits into an expression of a percentage on sales or a percentage on costs)—and if those misguided companies get the idea that extravagances are to their advantage, they will receive a very rude shock because actually, instead of getting a plus value for effecting positive economies, there will be applied in the settlement of their cases a very definite minus value for extravagance. The Price Adjustment Boards are interested first in the contribution by contractors to the war effort, and second in keeping down the cost of the war.





## Some Questions and Answers on Renegotiation of Government Contracts

**S**OME of the many interesting questions presented by members at the meeting of the Society on April 12, 1943 on "**Renegotiation of Government Contracts**" are considered to be of sufficient general importance to warrant their reproduction for the benefit of all the members.

These answers must be regarded as an expression of personal opinion by those answering the questions, and are not to be construed as representing an official opinion on the part of the Government or the Society as a whole.

**Question:** Must the final statement of the company be certified in all instances by an independent public accountant?

**Lt. Col. Dyson:** The War Department Price Adjustment Board has ruled that in cases of companies which have less than \$500,000 of renegotiable sales and which do not normally employ outside auditors, a final statement may be accepted if it is made under oath by a responsible company official having knowledge of the facts and control of the records from which the figures are obtained.

**Question:** How is the case opened? Does the Price Adjustment Board request figures initially, or is submission of figures required of every contractor subject to renegotiation?

**Commander McLaren:** The War and Navy Departments about three weeks ago were responsible for having introduced into Congress a proposed amendment to the renegotiation statute which would require the compulsory filing of returns, somewhat like tax returns or SEC filings, every year on the basis of year-end figures for every war contractor whose war sales were less than \$500,000. Now you will note that figure \$500,000. That is coupled with the second amendment which would exempt from renegotiation all contractors with war sales

in a fiscal period of less than \$500,000.

All the interested agencies of the Government are sponsoring the amendment calling for compulsory filing, and all the agencies, with the exception of the Maritime Commission, are sponsoring the raise to the \$500,000 sales exemption. The Maritime Commission has a special problem in that connection, which I won't go into now. I am not speaking for the Maritime Commission. I don't know what will be the fate of those amendments.

Now when the filing is made—and incidentally we have worked out a form in connection with voluntary filing which has been adopted by all the interested agencies—the clearance will be just as Colonel Dyson described it: to the agency having the predominance of interest in the contractor's war business will take jurisdiction; and from there on the procedure will be the same.

I believe that the compulsory filing in the form that we have had will not constitute any great headache to the contractors. It won't take long to prepare the forms. And, as to the \$500,000 exemption, I think it would be most helpful, in the long run, and simplify tremendously the administration of the statute; and the aggregate dollars of profits that might be called excessive that would be beyond renegotiation,

when considered percentagewise would not be very significant.

**Question:** If the non-war business shows a loss and the war business a profit, will the loss be taken into consideration in arriving at the amount, if any, to be paid to the United States Government?

If hostilities end in six months, will the company be allowed to open 1942 and have it reconsidered by including 100% of Certificate of Necessity equipment in overhead?

**Commander McLaren:** Well, that was a double-barreled question, and I will attempt to answer the last part first.

Under the renegotiation statute there is no authority for holding a case open pending the determination of the final treatment of amortization under the Certificates of Necessity. I would like to call your attention, however, to the fact that the amortization section of the Federal Revenue Act is based not on the time that hostilities end, but rather when the national emergency is declared to be at an end.

Now if at the end of hostilities we have anything like the type of political thinking that we have experienced for the last ten or twelve years, it is very unlikely the emergency will be declared ended immediately upon the cessation of hostilities.

Will you read the first part again?

**President Marvin:** If the non-war business shows a loss and the war business a profit, will the loss be taken into consideration in arriving at the amount, if any, to be paid to the United States Government?

**Commander McLaren:** The answer is no.

**Question:** If Defense Plant Corporation business is not included in a renegotiation will a clearance given by the Board to the contractor also cover that business?

**Lt. Col. Dyson:** No. The contractor will be given clearance only on those contracts and subcontracts listed in the agreement; i.e. on that portion of the business volume actually considered and included in the renegotiation.

**Question:** Are contracts renegotiable if no contract exceeds \$100,000 but the total of all of them does?

If individual sales for specific units in supplying contractors are paid by the contractor to the subcontractor before April 28, 1942, are these subject to renegotiation?

**Commander McLaren:** There is a provision in the statute to the effect that all contracts of over \$100,000 with specified Government agencies must contain a clause providing for renegotiation. But that has nothing to do with the \$100,000 sales exemption. If the company's sales—even though they be scattered through all four of the specified agencies; even though no sale is \$5,000—if the aggregate during the contractor's fiscal period are in excess of \$100,000, then the entire war business is subject to renegotiation.

On the second part, that raises a question that is a little bit technical; but I think it is important enough to dwell on for a moment.

Let us consider the simplest type of subcontracting business. We'll say that an aviation company has a good many subcontractors who supply component parts and sub-assemblies. Now if the business is on a purchase-order basis, then any sales under purchase orders that were fully paid for by the prime contractor before April 28, 1942, are not subject to renegotiation. On the other hand, in that industry and in the automotive industry, most of the subcontractors for the major prime supplies have scheduled orders months in advance. They may be in the form of a formal contract, or may be only in the form of a let-

## *Some Questions and Answers on Renegotiation of Government Contracts*

ter in which, for example, the prime contractor which is an aviation company may order so many thousand feet of a certain type of tubing, deliveries to commence at the rate of X thousand feet during the month of December, 1941, 2 X in January and February of 1942, 3 X in March, 1942—and so on—the total order, we'll say, being 20,000 feet.

Now even though the items scheduled for delivery before April 28, 1942, have all been paid for before April 28, if the entire schedule of deliveries under the original order has not been fully paid for, then all the profits are subject to renegotiation. That is a very well-defined principle of law. None other than Mr. Williston, on Contracts, expounds on that subject at some length. The test is whether the vendor enters into any additional promise after the original schedule of deliveries has been accepted by him.

**Question:** If Defense Plant Corporation business is subject to renegotiation at the option of the contractor would it be proper to offer him a larger margin of profit on all business as an inducement to include D.P.C. sales? Always provided that such inclusion would, notwithstanding the increased profit margin, result in a larger dollar refund to the Government.

**Lt. Col. Dyson:** No.

**Question:** What procedure may a contractor follow when he believes the amount requested will bring up difficulties with the Internal Revenue Department?

**Commander McLaren:** The answer to the last question, if I understand the question correctly, is that I cannot conceive of any circumstances that would result in the situation which was rather lugubriously presented in that question.

The whole problem of determination of taxable income is so highly opposite to that of renegotiation of excessive profits that I do not see under what circumstances that situation could arise. Actually, in the case of a year which was renegotiated before the tax return was filed, the amount of the recovery is stated as a reduction in gross sales price just as if the original sales price had been the amount established as fair after renegotiation. In that case the Treasury Department would have no interest whatsoever. There'd be no report, nothing in the income tax return indicating that renegotiation had been concluded.

In the case of a year for which the return had been filed and the tax paid, that situation is covered under Section 3806 of the Revised Statutes which appears as an amendment to the Revenue Act of 1942; and there the original return remains undisturbed. But in computing the dollar amount to be returned to the Government, the Treasury and the Price Adjustment Boards get together on the amount of the credit represented by the difference between the amount originally included as taxable income and the revised amount. The taxpayer is given credit for the tax differential and is then asked to refund only the excess.

I am not sure this answers the question, but this is about the only direct relationship between income tax accounting and renegotiation.

**Question:** If a contractor was paid in full except for a retained percentage at April 28, 1942 (that's your line of demarkation) is it considered fully paid and not subject to renegotiation?

**Lt. Com. Edwin H. Wagner, Jr.:** It must be fully paid for and delivered before April 28, 1942, to be excluded from renegotiation. If 10% was withheld for guarantee

that would subject it to renegotiation at April 28.

Well, the Commander has suggested I speak about the relatively small items. We might waive those. For example, if a ship was delivered and paid for prior to April 28, and the Navy had some question with respect to an item of about \$500 for oil that was on that vessel, I do not think the Navy Price Adjustment Board would say that the cost of that ship was open to renegotiation at April 28 for an item of \$500 on a ship costing perhaps \$10,000,000.

**Question:** Is the decision of the Price Adjustment Board in Washington final and binding on the contractor? What recourse does he have, if any, if he disagrees with the findings and it is impossible to arrive at mutual agreement? What happens if the contractor does not agree to the board's decision?

**Commander McLaren:** I find some difficulty in answering that question because it has never arisen as a practical matter. However, the officer of the Navy charged by Congress with the responsibility of administering the provisions of the statute is the Secretary of the Navy. He has formally delegated that authority to the Under Secretary of the Navy and the Navy Price Adjustment Board functions directly under the Under Secretary; consequently, if an impasse were reached, then the Navy Price Adjustment Board would refer the whole record of the case to the Under Secretary for appropriate action and, under the statute, the Under Secretary could forthwith, if he so desired, withhold payments due under current contracts. Also, under the Second War Powers Act, if he deemed it appropriate he could take over and operate the plant.

That situation, however, has not yet arisen as a practical matter.

**Question:** How is reasonableness of officers' salaries determined by the board? Is any consideration given to the income tax paid by officers on excessive salaries paid to them by the corporation?

**Commander McLaren:** The test of reasonableness of compensation to executives is one that is applied quite broadly and liberally by all the price adjustment boards. The main test is whether or not the basis of compensation is on an arms'-length basis.

If a large corporation with far-flung interests and listed securities—one subject to regulation by various bodies—pays a salary to one or a substantial number of executives—salary-plus-bonus, perhaps—which runs into a substantial amount, and which may greatly exceed in these cases the limitation set in the recently departed-but-not-greatly-lamented Byrnes order, the price adjustment boards attach practically no weight—or did attach practically no weight—to that order. On the other hand, in the case of a large corporation which may have had an arms'-length bargain with its president, for example, calling for compensation based upon a flat percentage of sales or a flat percentage of income before taxes, and if the effect of carrying out any such bonus arrangement as that by reason of large war sales were to bring about a compensation figure which was clearly out of reason, the boards would disallow what they deemed to be an excessive amount.

This problem comes up in a practical way particularly in the case of small corporations which, as business has improved, have found that it seems to be the fashionable thing to do to raise salaries of officers who are also the principal stockholders and in those cases it is not at all infrequent for price adjustment boards to cut the compensation down to a figure within reason. There isn't any formula, but the boards, being com-

*Some Questions and Answers on Renegotiation of Government Contracts*

posed of businessmen, approach it in a rather broad way, and I think encounter no great difficulty in convincing corporation executives as to the soundness of their findings.

**Question:** May specific contracts be excluded from renegotiation where the manufacturing operation as applied to the particular contracts is just getting underway and is more or less in the experimental stage?

**Lt. Col. Dyson:** Yes, in cases where the company so requests and can show that losses incurred in the fiscal year being renegotiated are properly chargeable as costs applicable to a contract to be performed during the following fiscal period. This is primarily an accounting question. Generally speaking sales under all contracts during the fiscal period should be included in overall renegotiation.

**Question:** A steamship company operates a large fleet of vessels in a personal service capacity for the War Shipping Administration. In addition, it has two small Navy contracts (a personal service operation of two Navy vessels over a few months' period). It is subject to U. S. A. recapture. Is it also subject to U. S. Navy renegotiation?

**Commander McLaren:** In the past week the War Shipping Administration has created its own price adjustment board, so that in the case mentioned, if the predominance of interest—as it clearly seems to be in this case—were in the War Shipping Administration, the entire war business of the company would be renegotiated by the company and the new War Shipping Administration Price Adjustment Board.

**Question:** With what speed does the Navy Price Adjustment Board act in the case of a corporation anxious to obtain renegotiation prior to filing (on time) its Federal in-

come and excess profits returns? Assume that company statements are available 45 days prior to tax return filing date and audit by independent certified public accountants can be completed 15 days before the return date.

**Lt. Com. Wagner:** The Navy Price Adjustment Board cooperates with contractors 100%. If they have the information prepared and in such shape that we can go ahead with renegotiation there will be no delay. We have had contractors who came in for a preliminary hearing and in two hours' time had closed renegotiation proceedings for the entire year.

You must bear in mind, however, that the information must be sufficiently adequate for the record. We will at no time postpone renegotiation if the contractor is ready to go ahead.

I think that answers the question rather fully.

**Question:** If there has been a main contract and, before completion of the same, a second contract is granted to cover additions not originally contracted for, should the two contracts be separately renegotiated or is it the practice to cover both the original and extension contracts under one renegotiation settlement?

**Lt. Com. Wagner:** I assume in this that you speak of a prime contract and perhaps a change-order in the prime contract. If the second contract referred to is a separate and distinct contract, it has nothing to do with what you term the main contract. Here we are dealing with two separate contracts. If it is a change-order, it is the same contract.

Renegotiation proceedings with all the price adjustment boards are handled on an over-all basis. The exception to that procedure might be shipbuilding. Where a company records profits on long-term ship-

building contracts on a percentage of completion basis these contracts are renegotiated generally on a completed contract basis.

The answer to the question, therefore, is that both contracts will be renegotiated within the one year.

**Question:** In a partnership doing war work, is a reasonable allowance for partners' compensation permitted as an expense?

**Commander McLaren:** The answer is yes; otherwise partnerships would be placed at a very definite competitive disadvantage as compared with concerns in the same line of business who happen to be operating under corporate form.

**Question:** Is there any general average percentage of profit which is considered normal for a new war business with no previous records?

**Commander McLaren:** Well, I think the answer to the question is very simple. Obviously, if a new business without any experience of past earnings or past losses comes before the board, the posed question of pre-war profits is out. However, in determining a fair margin of profit in a new company which may be in a field such as textiles, for example, where the ordinary profit levels are low, in determining a reasonable margin of profit in an enterprise of that character the experience of other comparable companies would be given considerable weight.

**Question:** A corporation acts as sales agents for machinery manufacturers, and its earnings consist of fixed commissions on sales. Are the net profits from the commissions on sales made to the departments for the account of the manufacturers subject to renegotiation?

**Commander McLaren:** It is virtually certain, I believe, as a result of the hearings which the Vinson Committee is now conducting in Washington, that excessive commissions made by sales representatives will be made subject to renegotiation, probably by the enactment of a rider to one of the pending pieces of legislation. I don't think it will come in as an amendment to the renegotiation statute.

What has happened is that there have been two kinds of cases which have caused the Government procurement officers in every division considerable headaches. The first is that of the Washington representatives who drum up business through the government agencies and some of whose total compensations for the years '41 and '42 were utterly out of reason. The other is the case which you find in the machine tool industry and many others where individuals or firms have the exclusive sales agencies for a territory and receive huge commissions whether they have had anything to do with securing the business or not. Both the War and Navy Departments are disturbed about those situations, so I think they will be taken care of shortly by specific legislation.

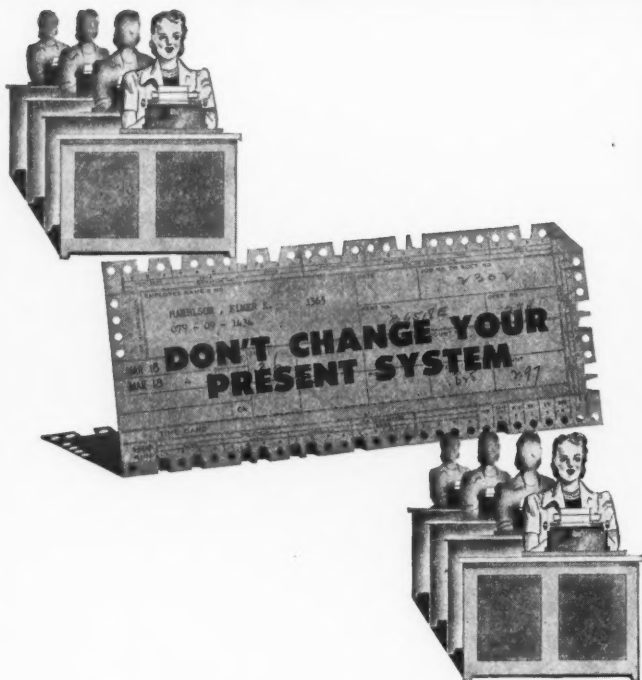
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